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EXEMPTIONS

2566. Employer-provided bursaries

The National Treasury (Treasury) released the Taxation Laws Amendment Bill 2016 (TLAB) in October 2016. The TLAB aims to give effect to the various tax proposals announced in the 2016 National Budget.

By way of background, section 10(1)(q) of the Income Tax Act, 1962 (the Act) exempts from taxable income, any bona fide scholarship or bursary granted to assist or enable any person to study at a recognised educational or research institution. However, if such scholarship or bursary has been granted by an
employer to an employee or relative of such employee, the exemption will not apply:

- if the bursary or scholarship has been granted to enable or assist any such employee, unless the employee agrees to reimburse the employer if the employee fails to complete their studies for reasons other than death, ill-health or injury; or

- in the case of a scholarship or bursary granted to enable or assist any relative of an employee:
  — if the remuneration proxy (as defined in section 1 of the Act) derived by the employee for a year of assessment exceeds R250,000;
  — the scholarship or bursary in respect of studies from Grade R–12 or a qualification to which a NQF level from 1 up to and including 4 has been allocated exceeds R10,000; and/or
  — the scholarship or bursary in respect of a qualification to which a NQF level from 5 up to and including 10 has been allocated, exceeds R30,000.

The monetary limits associated with bursaries and scholarships to relatives of qualifying employees were last revised in 2013 and Treasury has realised that it has become necessary to align the monetary limits with the ever-changing economy. Increasing these thresholds will most likely support skills development and encourage the private sector (employers) to provide education and training.

The TLAB proposes that the monetary limits be increased for bursaries and scholarships granted by employers to employees or relatives of qualifying employees as follows:

- remuneration proxy for qualifying employees will be increased from R250,000 to R400,000; and

- exempt bursaries or scholarships will be increased from R10,000 to R15,000 and from R30,000 to R40,000 respectively.
It is clear from the above that the aim of the proposal is to assist low-income earners in providing their dependants and relatives with the necessary education, skills and training. This in turn will enable them to enter the job market and participate in growing the economy. This is also a meaningful and viable way in which employers may continue to make a long lasting positive contribution to alleviating the socio-economic challenges faced by our society, as well as bridging the gap between unemployment and poverty levels in a sustainable manner.

In conclusion, any *bona fide* scholarship or bursary granted to enable or assist any person to study at a recognised educational or research institution is exempt from normal tax. However, this exemption is subject to certain conditions, particularly where the scholarship or bursary is granted by an employer (or an associated institution to that employer) to an employee or relative of such employee.

Cliffe Dekker Hofmeyr
ITA: Section 1(1) - definition of ‘remuneration proxy’; Section 10(1)(q)
Draft Taxation Laws Amendment Bill, 2016

INTERNATIONAL TAX

2567. OECD/G20 BEPS project developments

The European migrant crisis has reached catastrophic proportions. In 2015 more than a million migrants and refugees from Syria, Afghanistan, Iraq and other Asian and African countries fled from war and conflict, to Europe. The European Union (EU) is struggling to cope with the influx, which has caused schisms in the EU over how best to deal with resettlement of these displaced persons. Some European jurisdictions have been willing to accept asylum seekers while others have responded by increasing funding for border patrol operations in the Mediterranean and re-introducing border controls within the Schengen Area.
The EU’s single market was dealt a blow in June of this year when the United Kingdom (UK) voted to exit the EU (Brexit). Article 50 of the Treaty on the EU, which governs the withdrawal process, has never been activated before and while the UK appears to be angling for a more gradual exit through an informal process of negotiation; the remaining EU jurisdictions are eager to get the formal process underway, no doubt for fear, among other things, of political contagion. Uncertainty reigns as pundits try to predict how Brexit will play out.

The campaign of United States (US) President-elect, Donald Trump, has caused division in the US and even within his own Republican party. Political extremism, violence and division continue unabated across the globe, and the world appears to have run mad.

All the more commendable then is the momentum sustained by the inter-jurisdictional collaboration required to implement the OECD/G20 BEPS Project, which seeks to eliminate opportunities for cross-border tax avoidance and evasion while effectively and efficiently preventing double taxation. These endeavours are critical to the establishment of a robust international tax system capable of supporting economic growth and a resilient global economy.

More than 100 countries and jurisdictions, including South Africa, are now collaborating to achieve cross-border equity and integrity between tax systems and much effort is being exerted to achieve fiscal transparency and tax capacity building programmes, particularly for developing countries.

One of the most exciting endeavours of the OECD/G20 BEPS Project, particularly when juxtaposed with the accelerating disintegration of any semblance of unified global action for good, is the progress being made on BEPS Action 15 – the Development of a Multilateral Instrument to Implement Tax Treaty related BEPS Measures.
Several OECD/G20 BEPS Project recommendations are to be implemented through amendments to double taxation agreements (DTAs). If undertaken on a DTA-by-DTA basis, the sheer volume of DTAs in effect would make the process arduous and protracted. Recognising the need for an efficient and effective mechanism to implement the DTA-related measures resulting from the BEPS Project, Action 15 of the BEPS Action Plan called for the development of a multilateral instrument.

Public international law and tax experts analysed the possibility of developing a multilateral instrument to allow countries to amend their DTAs to implement the DTA-related BEPS recommendations and concluded that such a multilateral instrument was not only feasible but desirable.

In May 2015 an Ad Hoc Group comprising 96 countries all participating on equal footing, including South Africa, together with a number of non-State jurisdictions and international organisations participating as observers, was established with the objective of developing a multilateral instrument to modify existing DTAs in order to swiftly implement the tax treaty measures developed during the course of the OECD/G20 BEPS Project. The aim of the Ad Hoc Group is to conclude its work and open the multilateral instrument for signature by 31 December 2016.

The tax treaty provisions to be implemented through the multilateral instrument include:

- The provisions developed under BEPS Action 2 (Neutralising the Effects of Hybrid Mismatch Arrangements) to amend the OECD Model Tax Convention (MTC) with a view to ensuring that hybrid instruments and hybrid entities (including dual-resident entities) are not used to obtain undue DTA benefits; more specifically:
  - the revision of Article 1 (Persons Covered) of the OECD MTC to address fiscally transparent entities. Hybrid entities are entities classified differently for tax purposes in two or more jurisdictions.
In consequence of the divergent classifications, one jurisdiction may treat the hybrid entity as fiscally transparent or non-taxable (eg a partnership for South African tax purposes) while the other jurisdiction may treat it as a non-transparent taxable entity (eg a company). When a particular entity is afforded varying tax treatment in different jurisdictions, either double taxation or double non-taxation may arise; and

- measures to address issues with the application of and interaction with domestic law of the exemption method to relieve double taxation (Article 23A of the OECD MTC).

- Provisions developed under BEPS Action 6 (Preventing the granting of DTA benefits in inappropriate circumstances), as follows:
  - the minimum standard to counter treaty shopping through the introduction of an express statement in DTAs that the common intention of the relevant Contracting States is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements, while clarifying that DTAs do not restrict Contracting States’ rights to tax their own residents, hence providing some flexibility in the implementation of the minimum standard to accommodate adaptation to each country’s specific circumstances and negotiated DTAs;
  - a general anti-avoidance rule providing that if the principal purpose of a transaction or arrangement is to obtain DTA benefits, such benefits will be denied unless granting the benefits will align with the object and purposes of the provisions of the relevant DTA; and
  - specific anti-abuse rules pertaining to:
    - certain dividend transfer transactions intended to artificially lower withholding taxes payable on dividends;
transactions involving immovable property holding companies, which seek to circumvent the application of DTA provisions that allow for source taxation of the proceeds from the sale of shares that derive their value predominantly from immovable property located in the source jurisdiction;

- situations of dual-resident entities; and

- treaty shopping employing third-jurisdiction permanent establishments (PEs), which results in non-taxation or preferential tax treatment of the PE’s income.

The provisions developed under BEPS Action 7 (Preventing the Artificial Avoidance of PE status) which include:

- measures to address commissionaire arrangements (whereby a person sells products in a given State in its own name but on behalf of a foreign enterprise that is the owner of the products; in consequence of which the foreign enterprise is able to sell its products in a State without having a PE to which such sales may be attributed for tax purposes; and since the person concluding the sales does not own the products that it sells, it cannot be taxed on the profits derived from such sales, rendering it taxable only on the remuneration that it receives for its services (usually in the form of a commission)) and similar strategies;

- modifications to the specific activity exemptions excluded from the definition of a PE under Article 5(4) of the OECD MTC coupled with the introduction of an anti-fragmentation rule; and

- measures to address the splitting-up of contracts to exploit the exception in Article 5(3) of the OECD MTC, which provides that a building site, construction or installation project only constitutes a PE if it endures for more than 12 months.
• Work done under BEPS Action 14 (Making Dispute Resolution Mechanisms More Effective) including best practices and measures established as minimum standards (eg to ensure that DTA-related obligations related to the Mutual Agreement Procedure (MAP) are fully implemented in good faith and that MAP cases are resolved in a timely manner, ideally within 24 months of the commencement of the MAP; to ensure the implementation of administrative processes that promote the prevention and timely resolution of DTA-related disputes; and to ensure eligible taxpayers’ accessibility to MAP, including in transfer pricing cases etc.), in particular:

  o amendments to paragraphs 1 – 3 of Article 25 (MAP) of the OECD MTC, which paragraphs provide for MAP as an additional remedy (over and above anything which may be available at domestic law) in the case of a person’s justified grievance at being taxed by one or both of the Contracting States to a DTA in a manner inconsistent with the provisions of the MTC; and

  o provision for MAP to apply in cases contemplated under Article 9(2) of the OECD MTC when adjustments are made under a DTA by one Contracting State to the taxation of profits of an associated enterprise, the profits of which have already been taxed in the other Contracting State, allowing for the competent authorities of relevant Contracting States to remedy the double taxation precipitated by such adjustment on a semi open-ended basis.

• The MAP is of fundamental importance to the proper application and interpretation of DTAs. Action 14 aims to strengthen the efficacy of the MAP with a view to ensuring timely dispute resolution. It is encouraging that several countries have declared their commitment to provide for mandatory binding MAP arbitration as a mechanism to guarantee that DTA-related disputes will be resolved within a specified time frame in
consequence of which an optional provision on mandatory binding MAP arbitration is being developed as part of the negotiation of the multilateral instrument.

A number of technical issues arise in the course of developing a multilateral instrument to modify DTAs, including, but not limited to, ensuring compatibility between the provisions of the multilateral instrument and the existing DTA network; ensuring consistent application and interpretation of the DTA-related BEPS outputs across the diverse range of DTAs by issuing a supporting explanatory statement or commentary in conjunction with the multilateral instrument; and ensuring the accurate modification of DTAs in multiple authentic languages. The multilateral instrument is being negotiated in English and French but will be employed to modify DTAs in several other authentic languages.

Having overcome far greater obstacles to reach this point, the Ad Hoc Group is forging ahead with the formulation of the multilateral instrument, undeterred by these technical issues.

When the multilateral instrument is opened for signature later this year, it will signify a milestone for public international law and tax law. The attainment of inter-jurisdictional collaboration on such a grand scale is cause for celebration, particularly when viewed in contradistinction with the current state of global divisiveness.

Cliffe Dekker Hofmeyr
BEPS Action Plans 2, 6, 7, 14
OECD Model Tax Convention: Articles 1, 5, 9, 23A, 25

TAX ADMINISTRATION

2568. Legal precedent
Legal precedent is an invaluable tool for interpreting legislation. If it can be demonstrated that a court has interpreted and applied the law in a particular manner in relation to a particular set of circumstances, it is likely that the same interpretation will be applied in subsequent decisions where the circumstances are similar. However, there are strict principles that should be followed when seeking to rely upon decided law as a basis for legal argument. If these principles are not observed, the conclusions drawn can be misleading.

Law students are warned at an early stage of their academic training to avoid a cavalier approach when citing legal precedent. They should first compare the facts of the matter on which they intend to rely with the facts that they are dealing with now. Thereafter, they should consider whether the underlying law or statute under consideration is the same as that to which their matter relates and whether the same or analogous principles are applicable. Only once they have established that the facts and law are sufficiently comparable, may reliance be placed on the earlier decision to support their argument.

The hierarchy of the authority of decisions in our courts is such that a decision of the Supreme Court of Appeal must be applied by the courts unless a subsequent decision of that same court declares that earlier decision to be wrong. Decisions in the High Court are binding on that division of the High Court and on courts of subordinate jurisdiction, and are generally persuasive.

**Applying precedent that is not applicable may lead to unintended outcomes**

The following extract is taken from the draft *Guide on the Taxation of Professional Sports Clubs and Players* issued by SARS for public comment:
A sponsor that receives advertising and promotional services from a club in exchange for the sponsorship derives gross income, even though not in the form of money. [...] Gross income includes all receipts and accruals, not of a capital nature, whether ‘in cash or otherwise’. The services provided by a club under a sponsorship arrangement to a sponsor clearly constitute a receipt or accrual ‘otherwise’ than in cash as contemplated in the definition of gross income. The sponsor will therefore be taxed on the market value of the services provided to it by the club. (Emphasis added)

It is well established that the question whether an amount constitutes gross income is a question to be determined in light of all of the facts and that each matter should be decided on the merits of its own facts. There is no single test that will provide a reliable determination in all cases. It is therefore surprising that SARS should reach a categorical conclusion on the income tax implications to the sponsor that it apparently asserts will apply universally where a sponsorship agreement is entered into.

For there to be ‘gross income’ there must be an amount in cash or otherwise, received by or accruing to a person, that is not of a capital nature. SARS’ argument is that an amount accrues and therefore the amount is gross income. There is no discussion whether the receipt or accrual might be of a capital nature – it is apparently assumed that it is not.

SARS claims support for its conclusions in the decision of the Supreme Court of Appeal in C:SARS v Brummeria Renaissance (Pty) Ltd and others [2007] 69 SATC 205 (SCA). In that matter, an operator of schemes of housing for the aged granted life rights (rights of occupation of immovable property) to persons, who, in consideration, agreed to lend a specified amount of money to the grantor free of interest for the duration of the existence of the right.
The Court had only to decide whether an ‘amount’ had accrued to the grantor of the life right and found that an amount accrued if it had an objectively determinable monetary value.

The grantor had not raised as an issue the question of whether the amount, if any, was or was not of a capital nature, and therefore the question whether gross income had accrued was contingent only on whether an amount had accrued to or in favour of the grantor.

Thus the decision dealt only with one element of the overall requirements for determining whether a receipt or accrual constitutes gross income. It is clearly not authority for the conclusion reached by SARS that services received as a quid pro quo for a sponsorship constitute gross income.

The true nature of sponsorship is well identified in the draft guide. SARS endorses the following definition which is applied by the Advertising Standards Association:

... *a form of marketing communication whereby a sponsor contractually provides financial and/or other support to an organisation, individual, team, activity, event and/or broadcast in return for rights to use the sponsor's name and logo in connection with a sponsored event, activity, team, individual, organisation or broadcast.*

A sponsor provides support to a person, activity, club or event in exchange for rights to have its name and logo publicised in association with that person, activity, club or event. The sponsor acquires an asset—a right to have its name associated with the person, activity, club or event. Whether the arrangement may result in an accrual of gross income hinges on the circumstances of the arrangement.
If the sponsor purchases the right by way of a cash payment, the services provided by the event organiser represent a purchased service that will likely give rise to a deduction. If, on the other hand, the sponsor barters its products or services in exchange for the right to publicity, the services that it receives in consideration for the supply of goods or services would be gross income. This distinction is not made in the draft guide.

The draft guide then goes on to advise how the amount of the ‘income’ should be determined. Here it cites a judgment of the High Court in the Western Cape, namely South Atlantic Jazz Festival (Pty) Ltd v C:SARS [2015] 77 SATC 254 and states:

*The main principle that emerges from this case is that when assets or services are provided by a sponsor to a club in exchange for advertising and promotional services to be rendered by the club, the agreed market value of the sponsored goods and the services to be rendered by the club under the sponsorship arrangement will be the same, ‘in the absence of any contrary indication’.*

The decision upon which SARS relies was not an income tax matter but a VAT dispute. In that matter, certain sponsors of an event chose to provide ‘in kind’ sponsorship in exchange for promotional advertising. SARS assessed the event organiser to VAT in respect of the sponsorship value stated in the sponsorship agreement. However, it refused to allow a deduction of input VAT to the event organiser in respect of VAT on the services received, arguing that the sponsorship agreement was not acceptable as a substitute for a tax invoice for the purposes of the Value-added Tax Act.

The main principle that emerged was that sponsorship agreements were an acceptable substitute for a tax invoice for the purpose of assessing a liability to VAT.
One of SARS’ objections to the use of the agreements was that the value of services to be supplied by the sponsors stipulated in the agreements did not reflect the value of the publicity that constituted the consideration given for such services. However, the Court found against this submission, holding that the value stipulated in the sponsorship agreement had been used by SARS to determine output VAT payable by the organiser and, in the circumstances, it would be reasonable to conclude that the stipulated value of the sponsors’ goods and services had been received by the organiser.

In effect, the High Court found that SARS had itself placed reliance on the amounts specified in the contract and not on the actual value of what might have been given or received in determining output tax, and, as no evidence had been adduced concerning the value of goods and services received from the sponsors, it was reasonable to conclude that the services provided by the sponsors had been of the same value.

The High Court did not specify that the sole test for the value of an amount is by reference to the amount specified in the agreement; it came to this conclusion because it had no other evidence upon which to base a valuation. Had appropriate evidence been led, it is quite possible that the Court might have come to a different conclusion.

**Conclusion**
The document from which the extract was taken is a draft that was circulated for public comment.

However, it serves to highlight how easily reliance on precedent may lead to erroneous outcomes unless the principle of comparability is rigorously applied. One may sympathise with SARS, as the intention behind the document is to provide guidance for persons who may become involved in promoting and sponsoring professional sporting activities or events, and to do so with brevity.
However, the need for brevity should never overshadow the requirement of accuracy and reliability.

PwC

Draft SARS Guide on the Taxation of Professional Sports Clubs and Players

Editorial Comment: Draft guides should always be treated with care as there is no certainty that the final version will be identical to the publicly issued draft.

TRANSFER PRICING

2569. Country-by-country reporting (refer to Article 2525 July 2016 Issue 202)

In October 2015, the Organisation for Economic Cooperation and Development (OECD) published its final reports on the Base Erosion and Profit Shifting (BEPS) project, including the final report on BEPS Action 13, Transfer Pricing and Country-by-Country Reporting (Action 13 Report).

The Action 13 Report recommended a three-tiered approach to transfer pricing documentation, requiring a global master file and local file to be submitted by multinational enterprises (MNEs) to local tax authorities and a country-by-country (CbC) report to be submitted by the “ultimate parent entity” of an MNE in the jurisdiction in which it is tax resident. The CbC report will contain information to provide the tax authorities with an overview of the global allocation of income, business activities and taxes paid within the MNE. The tax authorities of various jurisdictions will share CbC reports through automatic exchange of information mechanisms, such as the Multilateral Competent Authority Agreement on the Exchange of CbC Reports, to which the South African Revenue Service (SARS) is a signatory.
In line with the other participants in the OECD’s BEPS project, SARS has issued draft guidance and legislation relating to transfer pricing documentation requirements. Although the OECD provides clear guidance and templates for tax administrations in respect of the proposed three-tiered approach, SARS’ guidance does not in all instances align with that of the OECD. In particular, on 15 December 2015, SARS issued a Draft Notice on transfer pricing documentation (Draft Notice) proposing comprehensive documentation requirements for South African resident MNEs with a consolidated group turnover of R1 billion or more.

While the documentation/record keeping requirements in terms of the Draft Notice have some similarities to the recommendations of the Action 13 Report, they are, in some instances, substantially more onerous. The terminology of the Draft Notice is also inconsistent with that of the Action Report in that the Draft Notice makes no mention of the master file/local file concept, nor does it deal with CbC reporting.

Subsequently, on 11 April 2016, SARS issued draft regulations in terms of the Tax Administration Act, 2011 (TAA) which will entrench CbC reporting in domestic legislation (Draft Regulations). The requirements for CbC reports in terms of the Draft Regulations follow the recommendations of the Action 13 Report closely. In particular, Article 4 of the Draft Regulations requires that CbC Reports must, *inter alia*, contain the information set out in, and apply the definitions and instructions contained in, Annexure III to Chapter V of the Action 13 Report.

This is somewhat surprising, since the recommendation of the Davis Tax Committee in respect of CbC reporting was that South Africa should require the disclosure of additional transactional data over and above that recommended by the OECD. Indeed, the Action 13 Report lists South Africa among the countries which would have preferred CbC reports to include additional data, particularly in relation to related party payments of interest, royalties and service fees.
Most recently, as of 18 April 2016, SARS has updated the ITR14 corporate income tax return (ITR14) with immediate effect to include, *inter alia*, significant new disclosure requirements in respect of transfer pricing. The new information required by SARS in the ITR14 includes the additional transactional data that the Davis Tax Committee recommended be included in the CbC report (i.e. a breakdown of intra-group interest, royalties and service fees by jurisdiction). Because the ITR14 falls outside the formal framework for the exchange of CbC reports, SARS will not be obliged to share the information obtained with other jurisdictions.

Furthermore, the transfer pricing sections of the ITR14 are potentially applicable to any “medium to large business” in terms of the Comprehensive Guide to the ITR14 Return for Companies, i.e. a company with total assets exceeding R10 million or gross income exceeding R20 million. This is a far cry from the CbC reporting threshold of R10 billion consolidated group revenue.

Briefly set out below are some of the relevant changes to the ITR14.

Firstly, it should be noted that the previous tax return required the disclosure of further transfer pricing information if the taxpayer had entered into an “affected transaction” as defined in section 31 of the Income Tax Act, 1962 (the Act). An “affected transaction” is essentially a cross-border transaction between connected persons, the terms of which are different from those which would have existed between independent persons dealing at arm’s length. The requirement to disclose further transfer pricing information in the tax return was therefore previously only triggered where there was a cross-border transaction between connected persons on non-arm’s length terms.

In the updated ITR14, however, the transfer pricing sections are required to be completed if the taxpayer has “entered into any transaction, operation, scheme,
agreement or understanding as set out in section 31(1)(a)”. The effect of this change is to remove the requirement that the transactions must have been on non-arm’s length terms. Any time there is a cross-border transaction between connected persons therefore, the taxpayer must complete the transfer pricing sections of the ITR14. Clearly, this is a significantly broader trigger requirement than before.

As regards the information required in the transfer pricing sections of the ITR14, the following is noted:

- Previously, and remembering that the return only related to “affected transactions”, the taxpayer was required to disclose the aggregate amounts paid/payable and received/receivable in respect of certain transaction categories, including the sale of goods, commission, interest, management fees and research and development fees. The aggregate amount receivable/payable for each category was required in respect of local, foreign connected and foreign non-connected persons.

- The updated transfer pricing sections require the categorised aggregate amounts in respect of foreign connected and non-connected persons. There is no longer a requirement to report the value of local transactions with connected persons.

- The updated return requires disclosure of the number of jurisdictions involved in the transactions for each category and, in the case of the top five jurisdictions by transaction value, the value of the transactions and a country code identifying the jurisdiction. This information is similar to that required in the CbC report in that it provides SARS with an overview of the allocation of group income and business activities between jurisdictions.

- The ITR14 is more limited than the CbC report in that it does not require values for each jurisdiction in respect of measures such as tax paid,
accumulated earnings, number of employees and tangible assets other than cash.

- The following new questions have been added to the “transfer pricing supporting information” section of the ITR14:
  
  o Was there any change between the company and non-resident connected person since the previous reporting period with respect to the transfer pricing methodologies/transaction, operation, scheme, agreement or understanding classification?
  
  o Did the company transact with a connected person that is tax resident in a country with which South Africa does not have a tax treaty?
  
  o Is the “tested party” of any transaction operation, scheme, agreement or understanding a tax resident outside South Africa?
  
  o How many “tested party/parties” of the transaction operation, scheme, agreement or understanding are a tax resident of another country?
  
  o Did the company, on or after 1990, transfer, alienate or dispose of any South African developed (or previously South African registered) intellectual property to any non-resident connected person or any foreign branch of a South African resident?

- In addition to the financial ratios required in terms of the transfer pricing sections of the old tax return, the taxpayer is now also required to provide a debt in relation to total tangible assets ratio.

According to the Action 13 Report, the recommendations attempt to balance the information needs of tax authorities with the compliance costs imposed on business, as well as concerns about inappropriate use of the information. Certain emerging market countries including South Africa, would however, have struck
the balance differently in favour of further reporting requirements. The new ITR14 will bring a far greater number of entities within its reporting requirements than will the CbC reports and SARS will not be required to share the resulting data with other tax administrations.

The introduction of the new ITR14, therefore provides SARS with a valuable new transfer pricing risk assessment tool. In the process however, a significantly increased compliance burden has been handed to the taxpayer.

ENSafrcia
ITA: Section 31 - definition of ‘affected transaction’
TAA: Draft notice in terms of section 29 and draft regulations for purposes of paragraph (b) of the definition of ‘international tax standard’ in section 1 BEPS Action 13 - Transfer Pricing and Country-by-Country Reporting

Editorial Comment: Draft documents should always be treated with care as there is no certainty that the final version will be identical to the publicly issued draft.

VALUE-ADDED TAX

2570. Delivery service

In Case No VAT 1390, heard in the Cape Tax Court in May 2016, the taxpayer, a food delivery enterprise, argued unsuccessfully that the actual delivery process was not part of its enterprise. In consequence, the court found that the delivery costs were subject to output tax. And in arriving at its decision, in interpreting the legislation the court looked at the economic reality of the taxpayer’s business and applied the legislation in terms of that reality.

The taxpayer, a registered a vendor under the Value-Added Tax Act, 1991 (VAT Act), conducted a fast food delivery business. The taxpayer contracted with fast
food outlets and takeaway restaurants to advertise their menus in a booklet which it had printed and distributed to households in the areas in which it made deliveries. Typically, a customer would phone the taxpayer and place an order from a particular fast food outlet. The taxpayer would relay the order to the outlet. For the actual delivery, the taxpayer used the services of a group of drivers whom the taxpayer described as independent contractors. When a delivery was due, the first driver in the queue would take control of the order.

This person, using private transport, would collect the order from the food outlet, deliver it to the customer, collect the payment in cash or by card, and report to the taxpayer. The tax invoice reflected the price of the meal, to which VAT was added, and an amount described as “Drivers Petrol Money”. VAT was not added to the Drivers Petrol Money, and this was the subject of the dispute between the taxpayer and SARS. The fundamental issue in the appeal was whether the delivery of food orders to the taxpayer’s customers constituted a service supplied by the taxpayer for consideration in the course or in furtherance, of its enterprise.

The taxpayer contended that the delivery process was not part of its enterprise. The driver was an independent contractor conducting a separate enterprise from that of the taxpayer. In other words, the taxpayer was claiming to be conducting a delivery service but was simultaneously contending that it was not making deliveries. The Drivers Petrol Money was a matter between the driver and the customer and the driver was not accountable for it to the taxpayer. It appeared on the invoice solely to inform the customer of the fee payable to the driver for the delivery service.

Unfortunately for the taxpayer, the standard contract between the taxpayer and the “independent contractor” driver was replete with conditions typically found in an employment relationship, such as hours of work and the description of the relationship as “employment”. In addition, the driver had to wear clothing of a
particular colour and prominently bearing the name of the taxpayer’s business. The containers for the food were similarly marked and coloured.

The court followed the approach of recent UK decisions in determining the economic reality of the transactions. And this reality was that the taxpayer held itself out as offering a food delivery service, in return for which it received a commission from the food outlet.

It was difficult to conceive of a delivery service which did not include delivery. The court commented at paragraph 29:

“The UK Supreme Court has recently acknowledged that ‘consideration of economic realities is a fundamental criterion for the application of the … system of VAT …, and … where a transaction comprises a bundle of features and acts, regard must be had to all the circumstances in which the transaction in question takes place’; see Revenue and Customs v Aimia Coalition Loyalty UK Ltd [2013] UKSC 15, [2013] 2 All ER 719 (SC), at para 56. At para 66 of the judgment, Lord Reed underscored the point stating:

I would at the same time stress that the speeches in Redrow should not be interpreted in a manner which would conflict with the principle, stated by the Court of Justice in the present case [see Commissioners for Her Majesty's Revenue and Customs v Loyalty Management UK Ltd and Baxi Group Ltd (Joined Cases C-53/09 and C-55/09) [2010] EUECJ C-53/09, [2010] STC 2651]], that consideration of economic realities is a fundamental criterion for the application of VAT.”

In light of all the circumstances, the economic reality was that the delivery process was a part of the enterprise and output tax was chargeable on the delivery cost.

Based on this analysis, the Tax Court held that the Drivers Petrol Money is a payment made by the customer in respect of, or, in response to the service
provided by the taxpayer, whether that service comprises the actual supply or the arranging of the supply of the delivery service. The driver’s right to retain the payments received is in terms of their contract with the taxpayer, and not in terms of any agreement with the customer. The Drivers Petrol Money was therefore held to be subject to VAT in the hands of the taxpayer.

The judgment of the Tax Court provides valuable guidance as to whether any amount charged to a customer, including delivery fees, comprises consideration for a service supplied to the customer which attracts VAT. Delivery fees and similar charges are often considered to be merely a non-taxable reimbursement of costs incurred on behalf of the customer, and their VAT status should be reviewed in view of this judgment. In determining whether such charges are subject to VAT, it is not sufficient to rely only on the agreements between the parties, but the facts and the commercial and economic reality of the taxpayer's business should also be considered.

**Professor Peter Surtees and ENSafrica**

**2571. Supply of student accommodation**

For some time now there has been a shortage of accommodation for tertiary students in South Africa. Developers have seen the gap in the market and have started building apartment buildings to provide housing to students.

The typical arrangement works as follows: The owner of the building rents individual apartments to the students for a period of 10 months a year. The apartments come with beds and tables. There is a communal kitchen, a laundry facility, and a lounge area with a TV and Wi-Fi. Sometimes the owners let the buildings to tertiary institutions which, in turn, let the apartments to the students.
How should owners account for value-added tax (VAT) on the rent they charge for the supply of the accommodation?

Unfortunately, that is a difficult question to answer.

Under the Value-Added Tax Act, 1991 (VAT Act) the supply of a “dwelling under an agreement for the letting and hiring thereof” is exempt from VAT. So, a person letting a dwelling to a tenant must not charge VAT on the rental, and is not able to claim input tax on the supplies to it, notably, the cost of acquiring or constructing the dwelling.

The term “dwelling” is defined to mean “except where it is used in the supply of commercial accommodation, any building, premises, structure, or any other place or part thereof, used predominantly as an abode of any natural person or which is intended for use predominantly as a place of residence or abode of any natural person, including fixtures and fittings belonging thereto and enjoyed therewith”.

“Commercial accommodation” is defined, to the extent that it is relevant, as “lodging or board and lodging, together with domestic goods and services, in any house, flat, apartment, room, hotel, motel, inn, guest house, boarding house, residential establishment, holiday accommodation…or similar establishment, which is regularly or systematically supplied but excluding a dwelling supplied in terms of an agreement for the letting and hiring thereof”.

“Domestic goods and services” are “goods and services provided in any enterprise supplying commercial accommodation, including…cleaning and maintenance…electricity, gas, air conditioning or heating…a telephone, television set, radio or other similar article…furniture and other fittings…meals…laundry…or…water.”
The supply of commercial accommodation is not VAT exempt. In the typical arrangement described above, is the owner supplying residential accommodation (dwellings) to students, in which case it must charge no VAT on rentals, or is the owner supplying commercial accommodation, in which case it must charge VAT?

The answer to that question has a significant commercial impact: if the rental is subject to VAT, then students must pay an additional amount for their accommodation, unless the owner absorbs the amount of VAT.

At first blush it appears as if the owners are supplying commercial accommodation to the students. After all, the owners appear to be providing “lodging” together with goods and services like cleaning, electricity, TV sets, water, and laundry facilities.

However, the provision in the VAT Act relating to the exemption of the letting of a “dwelling” contemplates that the supply may be exempt even if it is supplied with “fixtures and fittings belonging thereto and enjoyed therewith”. The fact that the student apartments are provided with certain amenities is not decisive. (Compare the following statement at page 12 of the guide of the South African Revenue Service (SARS) titled VAT 411 – Guide for Entertainment, Accommodation and Catering (SARS Guide):

The supply of furnishings and fittings is not usually a reliable indicator of whether the supply should be characterised as a dwelling or commercial accommodation. Commercial accommodation is almost always supplied together with the use of furniture and fittings and access to certain facilities and amenities, but these could also be supplied together with a dwelling under the lease agreement, for a fully or partially furnished dwelling.

The real issue is whether or not the agreements under which apartments rented to students are “agreements for the letting and hiring” of a dwelling, in other words,
whether or not the agreements constitute lease agreements, in ordinary parlance – as distinct from, on the other hand, commercial accommodation which “involves making available the use of an accommodation unit which forms part of the assets or resources of the accommodation establishment to the guest under a general agreement, understanding, or licence to occupy” (SARS Guide at page 12).

Where owners rent apartments to students for longer periods (for example 10 months) together with furniture, utilities, laundries and communal areas, for an all-inclusive rent, it is more likely that the supply will be exempt from VAT. However, there is a fine line between the supply of a dwelling under a lease and the supply of commercial accommodation, and that each arrangement should be considered on the relevant facts.

In the case of Respublica (Pty) Ltd v C: SARS case number 864/2014 the taxpayer concluded a five year lease agreement with a university. The property was let for the sole purpose of accommodating the university’s students. The property was divided into smaller units which were furnished with a kitchenette, bathroom and bedroom/living area. The taxpayer supplied water and electricity, maintenance costs, management of the building, a common TV room and laundry services.

The university paid the taxpayer monthly rental. The rental included an amount for utilities. The taxpayer sought guidance from the court on the manner in which it should account for VAT. (Notably, the taxpayer sought an order to the effect that its supply to the university was one of “commercial accommodation”, and that it accordingly was liable to account for VAT at the relevant rate on the rental. The taxpayer did not seek an order to the effect that the supply to the university was that of residential accommodation.)

The court held that the word “lodging” in the definition of “commercial accommodation” should be given a wide meaning under the Act and that the term
should be read in conjunction with the purpose for which the property was let to the university, that is, for the purpose of accommodating students. The court accordingly held that, despite the fact that the university itself could not, and did not lodge in the building, the letting of the accommodation by the taxpayer to the university constituted the supply of “commercial accommodation” under the Act.

It is argued that this judgment is not support for the view that the supply of all student accommodation with amenities should be treated as “commercial accommodation”. The court did not consider at all whether or not the supply could have been that of a dwelling under a lease.

The Respublica case is, however, support for the position that if an owner of an apartment building leases the building to the university, and the university then sub-lets the apartments to students as a dwelling under a lease agreement, the supply of the building to the university will also be the supply of a dwelling under a lease agreement and, accordingly, exempt from VAT.

Finally, there is an important policy consideration alluded to above. The reason why the letting of residential accommodation is exempt from VAT is mainly because a VAT system should not discriminate against people who rent their residences, as opposed to owning their own residence where owning a residence is an exempt supply (see du Preez, H and Klein, AE *The value-added tax implications of the temporary change in use adjustments by residential property developers: an international comparative study* at page 61).

That consideration is even more pertinent where the tenants are students who, by virtue of the high cost of tertiary education, will no doubt in the overwhelming number of cases have less means than “ordinary” tenants to pay VAT if it were levied on rental for student accommodation.
Ideally, the Legislature should amend the Act to make it clear how the supply of student accommodation should be treated for VAT purposes.

Cliffe Dekker Hofmeyr

VAT Act: Section 1 – definitions of ‘commercial accommodation’, ‘domestic goods and services’ and ‘dwelling’

VAT 411 – Guide for Entertainment, Accommodation and Catering

SARS NEWS

2572. Interpretation notes, media releases and other documents

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